MULTIMEDIA UNIVERSITY

STUDENT ID NO

MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 1, 2017/2018

BIT 3104 – INTERNATIONAL TRADE AND POLICY

(All sections / Groups)

25 OCTOBER 2017
2.30PM – 4.30PM
(2 Hours)

INSTRUCTIONS TO STUDENTS

1. This Question paper consists of 3 pages with 5 Questions only.

2. Attempt **ALL** in Section A. Attempt any **TWO** questions in Section B. All questions carry equal marks and the distribution of the marks for each question is given.

3. Please write all your answers in the Answer Booklet provided.

Section A Attempt all questions

Globally, illicit financial flows has been raising concerns among both developed and developing economies given the potential negative implications on a country's economic fundamentals if the issue is left unaddressed. Similarly, over the years, Malaysia has constantly undertaken various preventive measures to combat such illegal financial flows. Regardless, the country has been continuously ranked among the top developing countries with the largest illicit financial flows.

In the recent *Illicit Financial Flows to and from Developing Countries: 2005-2014* report, Global Financial Integrity (GFI) indicated that Malaysia may have lost a whopping US$44.32bil (RM144.93bil) in 2014 alone due to illicit financial outflow, an amount equivalent to 66% of the federal government revenue in that year. The illicit financial flow amount reported by GFI was 10% of Malaysia's total trade value in 2014.

However, Bank Negara has refuted the figures released by GFI, stating that methodological shortfalls by the Washington-based non-governmental organisation have led to inflated estimates for Malaysia. "The numbers published by GFI simply does not make sense. As Malaysia is an open economy with total trade approximately 162% of the gross domestic product (GDP), statistical compilation errors are bound to arise. "But definitely not to the extent as reported by GFI. The organisation incorrectly assumes unrecorded financial flows to be synonymous with illicit financial flows," Bank Negara economics department director Fraziali Ismail tells *StarBizWeek*.

GFI's methodology in deriving illicit outflows is based on the aggregate of two methods – trade mispricing, which captures the under-invoicing of exports and over-invoicing of imports, and hot money narrow, which captures unrecorded transfer of proceeds via informal channels. Responding to queries by *StarBizWeek* via email, GFI revealed that funds were illegally siphoned out of Malaysia in 2014 through the trade misinvoicing tactics. "Trade misinvoicing occurs when export or import transactions are under- or over-priced. Doing so enables the trader to move money into or out of the country, thereby evading capital controls and appropriate tax payments.

"On a conservative estimate basis, 10% of Malaysia's total trade in 2014 disappeared through illicit financial outflow. This represents a serious issue. As a percentage of total trade, this places Malaysia at the ninth highest illicit financial flow intensity in Asia and the Pacific," says GFI. Bank Negara says that it is impossible to estimate illicit financial flow due to trade mispricing, as differences in international trade data compilation conventions result in grossly overestimated unrecorded flows. "GFI's attempt to remove the impact of re-exports on estimates of trade mispricing by removing re-exports via Hong Kong is inadequate.

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"In addition, failure to take into account the role of Singapore for Malaysia with regard to trade, leaves overestimates unaddressed," says Fraziali. The biggest contention by the central bank with regard to GFI's methodology is its consideration of errors and omissions (E&O) of balance of payments as illicit financial flow. "Importantly, E&O reflects statistical errors and unrecorded financial flows which does not necessarily imply funds are garnered through illicit means.

"As for the amount estimated through the hot money narrow channel, the errors and omissions of the balance of payments has averaged at 2% of total trade, which is well below the 5% benchmark threshold prescribed by the IMF (International Monetary Fund). It is also important to note that IMF and the World Bank have never identified illicit flows as an issue that affects Malaysia," says Fraziali. As of the fourth quarter of 2016, Malaysia's net E&O stood at RM20.13bil. However, the central bank stressed that only a certain portion of the amount could be considered as illicit financial flow as a significant chunk of E&O is revaluation of reserves.

Now in its seventh edition, GFI's illicit financial flow reports have always ranked Malaysia among the Top 10 developing countries with massive illicit financial outflow. Within the last 10-year period between 2005 and 2014, GFI indicated that 12% of Malaysia's total trade value or US$430.56bil (RM1.41 trillion) worth of illicit financial outflow, may have left the Malaysian shores. Similar to findings in the GFI's previous illicit flow reports, developing Asian countries continue to be associated with the largest dollar-denominated flows.

High unaccounted financial flows can be detrimental to the national economy as it results in lower revenue generation for the federal government. In current times where the government is fiscally-strained due to lower oil price environment and economic slowdown, it is highly crucial to plug such leakages of the national finances in the form of illicit financial flows. GFI urges governments globally to initiate concerted efforts to reduce illicit financial flows. Among the recommended measures are the establishment of public registries of verified beneficial ownership, adoption of the Financial Action Task Force's anti-money laundering measures and greater inter-government participation in automatic exchange of tax information.

The Government had also undertaken an array of pre-emptive measures to combat illegal financial flows through various cross-agency collaborations even before the issues were highlighted by the GFI report. This includes wide-ranging measures to combat illegal activities through initiatives to strengthen the regulatory framework, enforcement and surveillance mechanism of the National Revenue Recovery Enforcement Team (NRRET).

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The team comprises the Attorney General's Chambers, police, customs, Malaysian Anti-Corruption Commission (MACC), the Inland Revenue Board (IRB), Bank Negara, Domestic Trade, Co-operatives and Consumerism Ministry, Companies Commission of Malaysia and the Immigration Department.

"We have also spearheaded the enhancement of the Anti-Money Laundering and Anti-Terrorism Financing Act 2001 in 2014 and the enactment of the Money Services Business Act 2011 to mitigate transfer of funds through informal channels. More recently, the central bank, MACC and IRB have agreed to enhance their strategic cooperation in combating financial crimes, especially those involving corruption and tax evasion," adds Fraziali.

(Source : The Star (2017) Negative impact of trade misinvoicing.)

1. Based on the article, explain **FIVE (5)** effects of this to international trade.

(25 Marks)

2. How would "mis-invoicing" affect Malaysia's trade situation? Provide **FIVE (5)** justifications.

(25 Marks)

Section B Attempt any TWO questions

3. International Trade and Industry Minister Datuk Seri Mustapa Mohamed reported on June 5, 2017, that Malaysia's Gross Domestic Product grew by 5% in the first quarter of 2017 despite the economic uncertainty (The Star 2017). Provide **FIVE (5)** reasons the gross domestic product grew despite the uncertainties.

(25 Marks)

4. More multinational companies have moved their operations from Singapore to Malaysia. This movement was seen in the past 3 years (The Star 2017). Explain **FIVE (5)** reasons that could possibly caused the movements from Singapore to Malaysia.

(25 Marks)

5. The dates from Middle East are being closely monitored by the Health Ministry in Malaysia (The Star 2017). The dates has been rumoured to be contaminated. Suggest **FIVE (5)** ways how this situation may not recur.

(25 Marks)

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